Global Arbitration Review

The Guide to M&A Arbitration

Editor
Amy C Kläsener

The Guide to M&A Arbitration

Editor

Amy C Kläsener

Reproduced with permission from Law Business Research Ltd

This article was first published in November 2018

For further information please contact Natalie.Clarke@lbresearch.com

Publisher
David Samuels

Business Development Manager
Gemma Chalk

Editorial Coordinator
Hannah Higgins

Head of Production
Adam Myers

Production editor
Harry Turner

Copy-editor
Jonathan Allen

Proofreader
Anna Andreoli

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.globalarbitrationreview.com

ISBN 978-1-78915-100-8

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

Acknowledgements

The publisher acknowledges and thanks the following for their learned assistance throughout the preparation of this book:

ALIXPARTNERS

CLIFFORD CHANCE

DAVIS POLK & WARDWELL LLP

DENTONS

ESIN ATTORNEY PARTNERSHIP

FORENSIC RISK ALLIANCE

FRESHFIELDS BRUCKHAUS DERINGER LLP

KIM & CHANG

KING & WOOD MALLESONS

LAW OFFICES OF THOMAS WEBSTER

NAGASHIMA OHNO & TSUNEMATSU SINGAPORE LLP

NOERR LLP

PETER & PARTNERS

PRICEWATERHOUSECOOPERS LLP

THOUVENIN RECHTSANWÄLTE KLG

VANNIN CAPITAL LLC

WACHTELL, LIPTON, ROSEN & KATZ

WHITE & CASE SA

WILMER CUTLER PICKERING HALE AND DORR LLP

WOLF THEISS

Contents

Part II: Survey of Substantive Laws

Part I

Key Issues in M&A Arbitration

10

Drafting M&A Contracts to Minimise the Risk of Disputes

Jonathan M Moses[1]

As with every business transaction, mergers and acquisitions can result in disputes, and increasingly arbitration has become a potential forum to resolve them. The parties negotiating the M&A deal share an interest in ensuring a successful transaction, but also they will want to look out for their interests if the transaction does not proceed as planned. Steps can be taken in drafting the M&A agreement to minimise the risk of disputes and to ensure that any dispute proceeds in a manner that maximises the likelihood that the expectations of the parties will be met. But to accomplish these goals, practitioners must take great care, before the event, in drafting critical provisions of the transaction agreement and thinking through the sources of potential disputes between the parties.

In the United States, major M&A disputes typically are heard in federal or state courts, most commonly in the Delaware Court of Chancery. But with the growth in cross-border M&A, which increased from approximately $300 billion in volume in 1997 to over $1.3 trillion in 2016,[2] practitioners in the United States are increasingly being required to think through M&A disputes issues with the possibility that an arbitral forum may be the preferred one. The reasons for choosing arbitration in a cross-border context may include the perception that an arbitral tribunal will be more neutral than a national court, the confidentiality of arbitration, the greater ease of enforcing an arbitral award in the relevant jurisdictions, and the greater control that the parties will have over procedural matters, including discovery. In jurisdictions outside the United States and other developed markets, arbitration related to M&A transactions is likewise growing, in part due simply to economic developments resulting in more deals in those markets but also to the premium that economic actors in those jurisdictions put on arbitration as a mechanism to resolve disputes.

---

1 Jonathan M Moses is a partner at Wachtell, Lipton, Rosen & Katz. The author is grateful to his colleagues, including Mark Gordon, Ryan McLeod, Nick Walter, Celia Glass and Nic Molina, for their assistance in preparing this Article.

2 Michael Gestrin, OECD, *Cross-Border M&A on the Rise: Recovery or a Warning of Another FDI Crash?* at 1, 6 March 2017, https://www.oecd.org/investment/globalforum/2017-GFII-Background-Note-MA-trends.pdf.

M&A disputes generally fall into two categories: pre-closing, when one party determines it has a basis not to proceed and the other party must litigate to force the first to complete the transaction, and post-closing, if one (or both) of the parties believes its expectations were not met. The nature of the dispute will of course depend on the nature of the transaction: public company mergers are likely going to generate very different kinds of disputes than private company asset acquisitions. This chapter reviews some of the particular issues that may arise in each type of dispute (pre-closing and post-closing) when the M&A transaction is subject to an agreement to arbitrate, and it discusses potential ways to anticipate such issues when drafting the transaction agreement. These issues often come up in M&A transactions with US counterparties, particularly cross-border deals, but they apply to M&A transactions generally.

Pre-closing M&A disputes: getting the deal closed

The first goal of any M&A transaction is usually a successful deal, and the first goal of any transaction agreement is to maximise the likelihood that a deal is able to close. Presumably, the parties entering the transaction share this interest, although their particular perspectives will vary depending on their position. An acquirer, for example, may wish to protect itself against unforeseen developments and have a way to get out of the deal before closing. A target, by contrast, generally wants to allocate the risk of negative developments to the buyer and will wish to ensure certainty of deal closure, having made the strategic (and usually very public) decision to sell itself or the major asset at issue. When arbitration is the preferred forum, certain issues may need to be considered.

Ability to seek injunctive relief

One of the most important tools in M&A disputes is the ability to obtain injunctive relief to force a recalcitrant party to close a deal. It is standard for parties in M&A agreements to agree that either one will be irreparably harmed if the transaction does not close and that the parties therefore consent to injunctive relief as a remedy for a breach. And, in fact, there is a lot of truth to this. A merger or major asset sale or acquisition is a unique event in the life of a company, and even when that is not the case, M&A transactions often involve one or both parties taking actions that cannot be easily reversed or untangled. Money damages will often not be an adequate remedy. A simple provision might read as follows:[3]

> *The Parties agree that irreparable damage for which monetary damages, even if available, would not be an adequate remedy, would occur in the event that the Parties do not perform the provisions of this Agreement in accordance with its specified terms or otherwise breach such provisions. The Parties agree that the Parties shall be entitled to an injunction or specific performance to prevent breaches of this Agreement and to enforce specifically its terms and provisions, and each of the Parties agrees that it will not oppose the granting of an injunction, specific performance and other equitable relief on the basis that the other Party has an adequate remedy at law.*

3 The parties may also choose to include a provision that the party seeking injunctive relief shall not be forced to post a bond.

In theory, injunctive relief may come up in a variety of forms. For example, it might be necessary to ensure that a recalcitrant merger partner takes the steps necessary to obtain approval from regulatory bodies[4] or shareholders;[5] to ensure that a business or its key asset is operated in the ordinary course before closing and is not harmed; or to cause the transaction to close itself.[6] Injunctive relief against the consummation of the transaction could also be sought by a third party that believes that the merger will violate its rights under a separate agreement, such as a shareholder agreement or joint venture agreement, that it has entered into with one of the merger partners in connection with an unrelated transaction.[7] As discussed below, the terms of such shareholder agreements may be very important to consider in anticipating post-closing M&A disputes, and they frequently will contain arbitration agreements in the cross-border setting.[8]

The parties should be aware that obtaining injunctive relief to force a deal to close is not easy. Under Delaware law (which the parties often use to govern merger agreements in the United States), injunctive relief will only be granted on a showing of clear and convincing evidence, which is more burdensome than the preponderance of the evidence standard that governs suits for damages.[9] Therefore, as a practical matter, many lawsuits that start out with demands for injunctive relief are converted into suits for damages after the transaction has closed (or failed to close).[10]

One exception to this pattern was the seminal case of *In re IBP*, in which the Delaware Court of Chancery ordered Tyson, a leading chicken producer, to complete the acquisition of IBP, a major beef and pork producer. Vice Chancellor Strine, as he then was, rejected Tyson's argument that IBP had suffered a 'material adverse effect' – a major deterioration in

4 See, e.g., *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715, 756-57, 762-63 (Del. Ch. 2008) (granting order for specific performance for buyer to use all efforts to obtain antitrust approval).

5 Delaware law, for example, specifically allows parties to bargain for 'force-the-vote' provisions in merger agreements, which require the target company to put the merger to the vote of its stockholders, even if the target company board changes its recommendation that the stockholders vote in favour of the deal. See Del. Code. Ann. tit. viii, § 146.

6 See, e.g., *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14, 84 (Del. Ch. 2001).

7 For example, in 2011, Casino Group, the French supermarket chain, sought arbitration of a dispute with Diniz Group, a Brazilian company, arising out of a shareholder agreement through which the parties controlled CBD, a Brazilian supermarket. Casino sought injunctive relief to prevent CBD from merging with Carrefour, another French supermarket chain, in violation of the shareholder agreement, and to require Diniz to hand over control of CBD to Casino. The arbitration settled shortly before the hearing. See, e.g., Christina Passariello & Geraldine Amiel, *Casino Steps Up Brazil Battle*, Wall St. J. (July 4, 2011), https://www.wsj.com/articles/SB10001424052702304803104576424993052846656; James B. Shien, *CBD vs. Casino: How Brazil's Biggest Retailer Fought a French Governance Takeover – and Lost*, Kellogg School of Management (2015).

8 A pre- or post-closing challenge to an M&A transaction may also be pursued by a third party such as a public shareholder or a competing bidder that has no signed contract with either merger partner. Such a challenge would not typically be governed by an arbitration agreement, and certainly not the arbitration agreement in the merger agreement itself. These types of disputess, and the provisions that are typically crafted in anticipation of them, are therefore not reviewed in this chapter.

9 *IBP*, 789 A.2d at 52-54.

10 See, e.g., *Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd.*, 2014 WL 5654305, at *1 (Del. Ch. Oct. 31, 2014) (seller initially sought specific performance to close deal, but then converted request to claim for damages); *Williams Cos. v. Energy Transfer Equity*, L.P., 2017 WL 5953513 (Del. Ch. Dec. 1, 2017) (after seller failed to obtain injunction to force deal to close, parties continued in litigation concerning damage claims).

IBP's business, as discussed below – that would, under the terms of the merger agreement, allow Tyson to avoid buying it. The court ruled that an award of specific performance, requiring the merger to take place, was preferable to an award of damages that could not be quantified easily.[11] Whether an arbitral forum would be in a position to issue a final order requiring two major public companies to merge remains to be seen.

It is typical for transaction agreements that provide for arbitration to make clear that preliminary injunctive relief may also be sought in a national court. Agreements generally provide for this because a party seeking injunctive relief will need to move quickly to preserve the benefit of the deal, and parties often feel that only a national court can act with the required speed and certainty to give them effective relief. A simple emergency relief provision might read:

> *Notwithstanding any provision of this Agreement to the contrary, a party, including a party awaiting a final determination on the merits by the arbitrator, shall be entitled to seek a restraining order or a preliminary injunction in any court of competent jurisdiction to prevent any violation of the provisions of this Agreement.*

The rules of major arbitral bodies recognise that parties will often choose to make such requests to courts.[12] Therefore, it may be possible to seek an order from a court to preserve the *status quo* pending the outcome of an arbitration and to do so without prejudicing the availability of the arbitral forum. Nevertheless, the major arbitral bodies have also made significant efforts to change the perception that they cannot grant injunctive relief swiftly enough by adopting procedures for emergency action.[13] The result has been an increase in the number of emergency applications. For example, in 2016, the ICC saw 25 applications for emergency proceedings, compared with only 10 in 2015.[14] Choosing an arbitral body

11 *IBP*, 789 A.2d at 82-84.

12 See, e.g., American Arbitration Association, Commercial Arbitration Rules and Mediation Procedures, R. 38(h) (Oct. 1, 2013) ('A request for interim measures addressed by a party to a judicial authority shall not be deemed incompatible with this rule, the agreement to arbitrate or a waiver of the right to arbitrate.'); JAMS, Comprehensive Arbitration Rules & Procedures, R. 24(e) (July 1, 2014) ('Any recourse by a Party to a court for interim or provisional relief shall not be deemed incompatible with the agreement to arbitrate or a waiver of the right to arbitrate.'); International Chamber of Commerce, Arbitration Rules, art. 29(7) (Mar. 1, 2017) ('ICC Rules') ('Any application for such measures from a competent judicial authority shall not be deemed to be an infringement or a waiver of the arbitration agreement.'); International Centre for Dispute Resolution, International Dispute Resolution Procedures: International Arbitration Rules, art. 6(7) (June 1, 2014) ('A request for interim measures addressed by a party to a judicial authority shall not be deemed incompatible with this Article 6 or with the agreement to arbitrate or a waiver of the right to arbitrate.'); International Institute for Conflict Prevention and Resolution, Rules for Administered Arbitration of International Disputes, R. 13.2 (Dec. 1, 2014) ('A request for interim measures by a party to a court shall not be deemed incompatible with the agreement to arbitrate or as a waiver of that agreement.').

13 For example, the ICC rules specifically provide that 'the arbitral tribunal may, at the request of a party, order any interim or conservatory measure it deems appropriate.' ICC Rules art. 28(1). The ICC rules also provide that if a party needs interim relief before a tribunal can be appointed (a process that may take weeks), the party may seek the appointment of an emergency arbitrator, whose interim decisions are binding on the parties but may be overruled or modified by the tribunal that will be appointed to resolve the parties' dispute. Id. art. 29.

14 Javier Rubinstein et al., *Strategic Considerations in Selecting Emergency Arbitration*, (Oct. 13, 2017), https://www.law360.com/articles/974344/strategic-considerations-in-selecting-emergency-arbitration.

whose rules are viewed as enabling parties to act quickly may be an important factor in drafting an M&A agreement where arbitration is the preferred forum.

One expedited option, which some parties are beginning to use in cross-border transactions where at least one party is organised under Delaware law, is arbitration under the Delaware Rapid Arbitration Act.[15] This relatively recent statute is designed to offer businesses the same speed and predictability of a national court, but in an arbitral forum that provides greater confidentiality and can render an award that may be more easily enforced overseas. The Act is designed to streamline the arbitration process to the greatest extent possible, while still allowing the parties flexibility over how they wish to handle any dispute. For example, the parties may request the Delaware Court of Chancery to quickly appoint an arbitrator if they have not chosen one themselves; the arbitrator must issue a decision no more than 180 days after being appointed, unless the parties provide otherwise in their agreement; and the arbitral award is automatically deemed confirmed five days after it is issued, unless the parties agree in advance that it may be challenged.[16] A simple provision invoking the Act might read, in part, as follows:

> *The Parties agree that in order to obtain expeditious resolution of all disputes arising out of or relating to this Agreement (including, for the avoidance of doubt, any claim arising out of or related to the substantive or procedural arbitrability of any claim), all such disputes shall be exclusively resolved by final and binding arbitration under the Delaware Rapid Arbitration Act (10 Del. C. § 5801 et seq.) and the Delaware Rapid Arbitration Rules promulgated thereunder by the Supreme Court of the State of Delaware in effect at the time of the date of delivery of the notice of arbitration, except as modified herein.*

Arbitration clauses invoking the Delaware Rapid Arbitration Act are usually highly tailored, and may contain detailed provisions concerning the background of the arbitrators, the timing of procedural steps in the arbitration, and the procedure for the gathering of evidence. However, parties should remain aware that the Act is recent and its acceptance in jurisdictions outside Delaware as an appropriate arbitral process is not yet tested.

Provisions relevant to pre-closing relief

Contractual provisions relevant to closing M&A transactions can take many forms, but there are certain standard types of provisions that are worth highlighting as they pose particular risks of dispute, including in the context of an arbitration.

Efforts clauses

A 'best efforts', 'reasonable efforts' or 'commercially reasonable efforts' clause requires counterparties in an M&A transaction to take steps to make sure that various conditions to closing are fulfilled. Such conditions could include obtaining shareholder approval or regulatory approval. In cross-border transactions, which may involve differing corporate law or

15 Del. Code Ann. tit. x, § 5801 et seq.

16 For a summary of the Act, see Gregory V. Varallo et al., *The Practitioner's Guide to the Delaware Rapid Arbitration Act* (Mar. 2015), http://www.rlf.com/Files/11206_DRAA%20Book%20Final.pdf.

regulatory regimes, the process of getting such approvals may be unfamiliar for one of the counterparties and more drawn out than in a domestic transaction. Anticipating the steps involved and what each party will need to do to get to closing can be important, including what forum will most likely be able to grant enforceable relief.

A simple 'reasonable best efforts' clause might read:

> *The Parties will cooperate with each other and use their respective reasonable best efforts to take, or cause to be taken, all actions, and to do, or cause to be done, and to assist and cooperate with the other parties in doing, all things necessary, proper or advisable to consummate and make effective the transactions contemplated hereby as soon as practicable and to cause the conditions to the Merger to be satisfied.*

The parties can change the level of effort required under such clauses to suit their needs. Courts have often found it difficult to determine meaningful differences between terms such as 'reasonable best efforts' and 'commercially reasonable efforts,' and if the parties intend each other to take particular actions, they should consider defining the required conduct as precisely as possible, including the maximum expense that a party may incur in complying with such a condition.[17] Courts have, however, deemed provisions requiring that the parties take 'any and all actions necessary' to achieve a certain result to be a 'hell or high water' standard that goes beyond 'reasonable best efforts'.[18]

Material adverse event clauses

A material adverse event clause is also standard.[19] Such clauses allow a party to an M&A transaction to walk away if there is a major deterioration in the business of the counterparty. These clauses, as one might imagine, are heavily negotiated as they pose a threat to closing certainty. A very simple definition of an material adverse event clause might be as follows:

> *'Material Adverse Effect' shall mean any change, effect or circumstance that has a material adverse effect on the business, results of operations or financial condition of the Company, other than any of the following or any effect attributable to changes in general economic or political conditions, or any events, circumstances, changes or effects that affect the industries in which the Company or any of the Company's subsidiaries operate.*

US case law is typically sceptical of efforts to invoke such clauses in the merger context, and a buyer faces a 'heavy burden' if it wishes to use such a clause to avoid a merger.[20]

---

17 See, e.g., *Williams Cos. v. Energy Transfer Equity, L.P.*, 2016 WL 3576682, at *16 (Del. Ch. June 24, 2016) (under Delaware law, finding that 'commercially reasonable efforts' are 'similar' to 'reasonable best efforts'), aff'd, 159 A.3d 264 (Del. 2017); *Soroof Trading Dev. Co. v. GE Fuel Cell Sys. LLC*, 842 F. Supp. 2d 502, 511 (S.D.N.Y. 2012) (under New York law, equating 'reasonable efforts' with 'best efforts'). But see Lou R. Kling et al., *Negotiated Acquisitions of Companies, Subsidiaries and Divisions* § 13.06 (2017) (arguing that 'best efforts' imposes more of an obligation on a party than 'reasonable efforts', while noting that the terms are imprecise).

18 See, e.g., *Hexion*, 965 A.2d at 756.

19 This provision may also be called a material adverse effect or material adverse change clause.

20 *Hexion*, 965 A.2d at 738. See generally *Luxco, Inc. v. Jim Beam Brands, Co.*, 2016 WL 3136917 (N.D. Ill. June 6, 2016) (reviewing case law and, applying New York law, finding that no material adverse event had taken

Representations and warranties

It is also worth remembering that the various representations and warranties parties may make in the merger agreement are conditions to closing itself. As discussed below in connection with post-closing disputes, some of those representations and warranties may lose any force after closing and so the only time to exploit them is pre-closing.

Provisions to protect interests if pre-closing injunctive relief is not practical

Realistically, in cross-border transactions where arbitration is the preferred forum, obtaining injunctive relief may be even harder than in domestic disputes. If there is a truly recalcitrant transaction partner, a court order or arbitral award may not provide the necessary relief. The courts in the domicile of the party may not recognise an injunction issued by a foreign court,[21] and it may be difficult or impossible to have a preliminary award by an arbitral tribunal enforced by a court overseas.[22] Given the potential risk that one party to a cross-border M&A deal will be able to avoid closing the transaction, the parties may want to consider other tools to protect themselves. Below are some of the typical provisions that may be considered.

Reverse break-up fees

These provisions provide protection for the target if the transaction does not succeed. A failed transaction can be particularly damaging to a company, interrupting strategic planning and tarnishing value. A sufficiently high reverse break-up fee can provide a necessary check on the desire of a recalcitrant acquirer suffering from 'buyer's remorse' to walk away from a deal, and also certainty of adequate damages if the deal does not close.[23]

---

place). For a rare example of where a court has found that a material adverse event has taken place, see *Pan Am Corp. v. Delta Air Lines, Inc.*, 175 B.R. 438, 492-93 (S.D.N.Y. 1994) (permitting the airline Delta to withdraw an investment in its failing rival Pan Am in part on account of a triggered material adverse change clause). See also *Katz v. NVF Co.*, 473 N.Y.S.2d 786, 788 (App. Div. 1984) (noting that the potential merger parties had agreed that the proposed acquirer was relieved from its obligation to make an offer for the proposed target 'because of a material adverse change in [the target's] business and financial condition'); *Osram Sylvania Inc. v. Townsend Ventures, LLC*, 2013 WL 6199554 (Del. Ch. Nov. 19, 2013) (refusing to dismiss a post-closing claim by a buyer against sellers that a material adverse change had taken place before closing, giving rise to a claim for indemnification). In a recent ruling in the Delaware Court of Chancery, the court found that a MAC clause was, in fact, properly invoked to terminate a merger agreement pre-closing. *Akorn, Inc. v. Fresenius Kabi AG*, C.A. No. 2018-0300-JTL (Del. Ch. Oct. 1, 2018). It remains to be seen if the ruling survives a likely appeal.

21 See, e.g., S. Nathan Park, *Recognition and Enforcement of Foreign Provisional Orders in the United States: Toward a Practical Solution*, 38 U. Pa. J. Int'l L. 999, 1001 (2017) ('Although it is theoretically possible to obtain a provisional relief from a U.S. court to aid the main proceedings in a foreign country, such course of action is fraught with uncertainty and delay . . . .'). Another option may be to seek injunctive relief from the courts at the domicile of the recalcitrant rather than at the arbitral seat. The availability of such relief, and efficiency in obtaining it, may vary.

22 See, e.g., Peter J.W. Sherwin & Douglas C. Rennie, *Interim Relief Under International Arbitration Rules and Guidelines: A Comparative Analysis*, 20 Am. Rev. Int'l Arb. 317, 326-27 (2009).

23 A plain break-up fee (as opposed to a reverse break-up fee) is a fee that is paid by the target company to the acquirer in the event that the deal does not go through, for example if the target company enters into a merger agreement but then accepts a higher offer from another buyer.

Letters of credit

Negotiating a letter of credit to ensure deal closing may be very important if the counterparty is in a jurisdiction where there are concerns about the ability to enforce the contract in a timely and meaningful way. The letter of credit may provide funding for the acquirer's purchase, or, if the deal fails, it may be a source of payment for the break-up fee. Letters of credit are usually keenly negotiated and may include provisions that the target company is a third-party beneficiary of the letter of credit and may enforce its terms.

Escrow

For the same reason, parties to a transaction agreement may decide to use escrow arrangements to ensure that the agreed funds are available at the time of closing. Escrows may be particularly important when the buyer is a special purpose vehicle. Escrows are often used to support working capital and other purchase price adjustments and post-closing indemnification obligations, but they may also be used as a source for a break-up fee.

Post-closing M&A disputes: will money damages suffice?

Following deal closing, the possibility of a dispute of course remains. An acquirer may realise that the company or asset it purchased isn't exactly what it thought it was. Or, following a merger, one shareholder may feel that its expectations for the performance of the post-closing merged entity are not being met. Typically, post-closing disputes involve claims for monetary damages, but, in the case of mergers involving post-closing shareholder agreements or joint ventures, they can also include claims for injunctive relief. As will be discussed in Part II and Chapter 6 on legal remedies, unwinding is also available as a remedy in some jurisdictions. Again, practitioners drafting M&A agreements can take steps to anticipate and limit these risks, or at a minimum provide for reasonable means to resolve them expeditiously. A little planning may reduce the possibility of a dispute or materially improve a party's ability to enforce its expectations. The following reviews the potential issues around some of these provisions – particularly as they may arise in the context of arbitration – which can include limitations on liability related to representations and warranties, working capital true-ups, earn-outs, and governance mechanisms in the context of shareholder agreements following merger- or joint venture agreements.

Post-closing indemnification for breaches of representations and warranties

In certain M&A transactions – for example, the purchase of an asset or division of a company, or the private acquisition of a company from a single owner or small group of owners – the agreement is likely to provide for post-closing indemnification of the buyer by the seller if the buyer discovers after closing that some of the seller's representations and warranties were untrue. In such cases, a claim for money damages can arise. In some sense, these cases are standard breach-of-contract claims. Did the party breach the representation or warranty or not? But the M&A draftsperson can limit ongoing exposure through tools such as survival periods and limitations on the amount, or source, of any indemnification. Access to books and records post-closing may prove an obstacle in some instances.

A survival clause is often viewed as evincing a clear intent to bar any claims for breach of representation and warranty after the end of the negotiated period, notwithstanding a longer statute of limitations under state law.[24] A typical survival provision might read:

> *The representations, warranties, covenants and agreements of Buyer and Seller contained in or made pursuant to this Agreement or in any certificate furnished pursuant to this Agreement shall survive in full force and effect until the date that is 12 months after the Closing Date, at which time they shall terminate and after which time no claims for indemnification shall be made.*

Of course, the purchase agreement could also provide that the representations and warranties do not survive closing at all, thereby eliminating any post-closing claim for damages stemming from a breach. A very simple non-survival provision might read:

> *None of the representations, warranties, covenants or agreements set forth in this Agreement, including any rights arising out of any breach of such representations, warranties, covenants or agreements, shall survive the Closing (and there shall be no liability for monetary damages after the Closing in respect thereof).*

In either case, the parties are able to minimise uncertainty surrounding the period when representations and warranties made in the acquisition can be challenged.

Another common method of minimising post-closing disputes regarding representations and warranties is by including limits on liability. A typical limitation of liability provision for post-closing indemnification might read:

> *Notwithstanding anything contained in this Agreement to the contrary, in no event shall the Seller: (i) be liable for indemnification unless and until the aggregate amount of all Losses that are imposed on or incurred by the Buyer exceed the Deductible Amount, in which case the Buyer Indemnified Parties shall be entitled to indemnification for all Losses in excess of the Deductible Amount; and (ii) be required to make payments for indemnification in an aggregate amount in excess of the Maximum Indemnification Amount.*

The use of a minimum deductible amount can reduce disputes over relatively trivial items, while the total cap on liability provides certainty to the seller regarding its maximum exposure. As discussed above, the contracting parties may also wish to fund post-closing indemnification obligations through an escrow account, assuring the availability of the funds to the buyer and allowing the seller to proceed without fear of future costs. Finally,

24 See, e.g., *GRT, Inc. v. Marathon GTF Tech., Ltd.*, 2011 WL 2682898, at *15 (Del. Ch. July 11, 2011) ('A survival clause . . . is a tool utilized by contracting parties to avoid the uncertainty that learned commentary suggests exists where the contract is silent on the issue of survival.') (applying Delaware law). The parties should, as always, carefully consider the law of the jurisdiction that they have chosen to govern their contract. For example, under Californian law, a survival clause can only shorten the time that a party has to sue if its intent to override California's statute of limitations is made explicit. See *W. Filter Corp. v. Argan, Inc.*, 540 F.3d 947, 952–54 (9th Cir. 2008) (noting California's public policy against derogation of the statute of limitations).

the parties may also agree that claims for indemnification are the exclusive remedy for breaches of representations and warranties, and that arbitration is the exclusive forum in which to bring any such claim.

Care must be taken in drafting the terms of a representation or warranty to reduce the risk the seller be accused of fraud or misrepresentation. In certain jurisdictions, parties can limit their exposure to claims of extra-contractual fraud, or fraud in the inducement. For example, in Delaware and New York, if parties to a contract include a provision disclaiming any reliance on representations outside the four corners of the agreement, the law will bar claims for fraudulent inducement based on extra-contractual statements.[25] In other jurisdictions, the law is less clear-cut, and the parties should take care to understand their potential liability in advance of entering into contract.[26] And in many jurisdictions, findings of fraudulent conduct, such as providing intentionally false representations or warranties, can result in any liability caps or other limitations on relief being vitiated as a matter of law.[27] (See Part II of this Guide.)

Representation and warranty insurance is becoming increasingly common in M&A transactions. (See Chapter 5 on special issues in connection with indemnity and warranty insurance.) The aim of such insurance is to insure one party (almost always the buyer) against the risk that the other party has breached its representations and warranties. In some cases, the acquirer who has bought insurance may be willing to forgo any post-closing survival period for the representations and warranties. Such insurance is usually carefully negotiated, but can provide an attractive alternative or complement to standard representations and warranties and can limit a potential point of dispute between the parties.

True-ups

Post-closing true-ups of working capital or other balance sheet items are another increasingly common source of M&A disputes and are frequently resolved in proceedings outside court. The idea behind these provisions is simple. The parties agree to a target working capital at the same time as setting the overall deal consideration, and the seller agrees to

25 See *Abry Partners V, L.P. v. F & W Acquisition LLC*, 891 A.2d 1032, 1056 (Del. Ch. 2006) ('We have honored clauses in which contracted parties have disclaimed reliance on extra-contractual representations, which prohibits the promising party from reneging on its promise by premising a fraudulent inducement claim on statements of fact it had previously said were neither made to it nor had an effect on it.'); *Aetna Cas. & Sur. Co. v. Aniero Concrete Co.*, 404 F.3d 566, 576 (2d Cir. 2005) (observing that, under New York law, '[w]hen . . . the contracting party disclaims the existence of or reliance on specified representations, it will not be allowed to claim it entered the contract in reliance thereon.') (internal quotation marks omitted).

26 For example, California law is notably less clear than Delaware or New York law on this issue. It is against California public policy for parties to be able to exempt themselves by contract from negligent fraud, and anti-reliance clauses will be ignored. See *Manderville v. PCG & S. Grp., Inc.*, 146 Cal. App. 4th 1486, 1501-02 (2007) (citing Cal. Civ. Code § 1668). Courts applying California law may, however, take such clauses into effect in determining whether a party's reliance on the extra-contractual representation was reasonable. See *Hinesley v. Oakshade Town Ctr.*, 135 Cal. App. 4th 289, 302 (2005).

27 See, e.g., *Abry*, 891 A.2d at 1064 (Delaware public policy prohibits limitations on liability for intentional fraud); *Turkish v. Kasenetz*, 27 F.3d 23, 27-28 (2d Cir. 1994) (noting that, under New York law, '[i]t is well settled that parties cannot use contractual limitation of liability clauses to shield themselves from liability for their own fraudulent conduct.'). This principle also applies in civil law countries. See, e.g., Code civil art. 1231-3 (France); Código Civil Federal art. 2106 (Mexico).

compensate the buyer for any working capital shortfall at closing, while the buyer agrees to refund any working capital excess at closing. Between signing and closing, the target company must continue to operate and during that time its working capital may increase or decrease. A simple working capital true-up provision reads as follows:

> *The Closing Adjustment shall be set forth in writing by the Seller three days prior to closing and shall be equal to the amount of estimated working capital at closing less the Target Amount. If the Closing Adjustment is a positive amount, then the Purchase Price paid by the Acquirer at Closing shall be increased by the Closing Adjustment. If the Closing Adjustment is a negative amount, then the Purchase Price paid by the Acquirer at Closing shall be decreased by the Closing Adjustment.*

If the parties are unable to agree on the true-up, they may contractually agree to spend a certain period (such as 30 days) resolving the issue before seeking the help of a third party to resolve the question. Because the true-up is an extremely narrow issue, the parties may choose to have the issue resolved by an 'expert', whose authority is precisely limited to the determination of this factual question, rather than an 'arbitrator', who is usually considered to have a wider scope of authority and can draw legal conclusions.[28] (See Chapter 3 on conflicts between expert determination and arbitration clauses, and Chapter 9 on managing expert determinations.) The parties may choose to bargain for their own standard of judicial review of the expert's award, although in the United States a court may also choose to apply the Federal Arbitration Act, which provides for a very deferential standard of judicial review.[29] A very simple expert determination clause might read as follows:

> *In the event of a dispute between the parties over the proper calculation of the Closing Adjustment, the parties shall submit any items in dispute for resolution by an Independent Auditor, who shall be functioning solely as an expert and not as an arbitrator.*

There are many traps for the unwary in these provisions. Parties need to have a clear, mutual understanding of how 'working capital' is to be defined and calculated, and the definition must match the target company's customary operating accounting. If not carefully considered, this adjustment mechanism may be susceptible to manipulation, such as by challenges to line items or accounting methods not used by the seller, creating a potential mismatch in the post-closing true-up. The working capital dispute mechanism may also lead to attempts

28 See, e.g., *Chi. Bridge & Iron Co. N.V. v. Westinghouse Elec. Co. LLC*, 166 A.3d 912, 931 (Del. 2017) (noting that the language 'acting as an expert and not as an arbitrator' 'narrow[s] the scope of the expert's domain'); New York City Bar, Report by the Committee on International Commercial Disputes, *Purchase Price Adjustment Clauses and Expert Determinations: Legal Issues, Practical Problems and Suggested Improvements* 27 (June 2013) ['Purchase Price Adjustment Report'] (noting that an 'expert determination cannot decide the ultimate liability of a party').

29 See, e.g., *Seed Holdings, Inc. v. Jiffy Int'l A.S.*, 5 F. Supp. 3d 565, 576-78 (S.D.N.Y. 2014) (holding that review under the Federal Arbitration Act applied to a working capital true-up performed by an accounting firm, even though the purchase agreement did not use the term 'arbitration'). But see Purchase Price Adjustment Report at 20-23 (asserting that state law, not federal law, applies to 'expert' determinations and that the parties may choose to bargain for their own standard of review).

to avoid limitations on remedies that the parties agreed for a breach of the representations and warranties by providing another avenue to seek relief not tied to those breaches.[30]

Earn-out clauses

An earn-out is a provision in an agreement allowing the seller to obtain an increase in the purchase consideration based on the performance of the business post-closing. Earn-out provisions very frequently lead to post-closing disputes: as the Delaware Court of Chancery has observed, 'an earn-out often converts today's disagreement over price into tomorrow's litigation over the outcome.'[31] These disputes are again frequently resolved in expert or arbitral proceedings, and the parties may minimise the risk of dispute by negotiating the provision carefully in advance. Earn-out disputes, like working capital true-ups, are often relegated to the jurisdiction of independent auditors. A very simple earn-out provision might provide as follows:

> *'Earn-Out Payment Amount' for any Fiscal Year in the Earn-Out Period means the positive amount, if any, equal to the product of (x) the Net Profit for that Fiscal Year minus the Overhead Amount and (y) the Earn-Out Multiplier.*

Sometimes things don't work out as planned. Different legal jurisdictions will have their own approach to this issue. US law typically provides for a duty of the acquiring party to work in good faith to meet the earn-out expectations, but not to take extraordinary steps.[32] As might be expected, these kinds of provisions can distort incentives post-closing. Thinking through the nature of the business and potential ways to maximise the seller's protection of its economic expectations ahead of time is important. For example, potential protections for the seller could include specific actions that the buyer must take to maximise the seller's revenue, or an explicit requirement that certain money be paid on a deferred timetable without regard to the economic success of the ongoing business. Of course, the exigencies of a particular deal will dictate the negotiating leverage for a selling party.[33]

---

30 In the recent *Chicago Bridge and Iron* case, the Delaware Supreme Court stopped an attempt by one party to use the working capital process to circumvent the intent of a transaction agreement that claims regarding financial misstatements not surviving closing. 166 A.3d at 933 (in agreement where representations and warranties did not survive closing, buyer 'could only use the True Up to resolve disputes arising from changes in facts or circumstances of [the target company's] business between signing and closing.').

31 *Airborne Health, Inc. v. Squid Soap, LP*, 984 A.2d 126, 132 (Del. Ch. 2009).

32 See, e.g., *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609, 614 (2d Cir. 1979) (holding, under New York law, that even in the absence of a 'best efforts' clause, a buyer would have been under a good faith duty to ensure that 'substantial' royalties were paid); *Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808, 816-17 (Del. 2013) (holding, under Delaware law, that implied covenant of good faith and fair dealing applies to earn-out provision).

33 Any claim for post-closing damages will likely include a claim for interest. Parties to cross-border agreements with arbitration provisions should be aware that international arbitration tribunals may not apply the statutory rules for payment of interest of the jurisdiction whose law governs the arbitration agreement. See, e.g., New York City Bar Committee on International Commercial Disputes, *Awards of Interest in International Commercial Arbitration: New York's Law and Practice* 2 (June 21, 2017) ('International arbitrators have discretion to apply or not to apply New York's statutory prejudgment interest provisions to the determination of pre-award and post-award interest in an international commercial arbitration governed by New York substantive law and seated in New York . . . .').

Joint ventures and shareholder agreements

Parties in cross-border transactions commonly agree to plan to work together (or mix some assets) long term without fully merging or changing control. There are many issues to think through here depending on the nature of the deal, the parties' position in the post-closing entity, and the parties' long-term strategic goals: these may include control rights, rights in regard to certain operational or financial matters such as dividends, rights upon a future sale, and rights if one party changes control (leaving the other party in a relationship with a partner that it did not expect). These provisions, not surprisingly, are highly negotiated.

But one thing that is common to all joint ventures is the need to think through how disputes will be resolved in a way that minimises the negative effect on the business if it is intended to be a long-term relationship and to what extent a dispute will undermine the ongoing business. Some parties will develop elaborate dispute resolution provisions to do so. Arbitration, unsurprisingly given the overall goal of maintaining ongoing relations, is commonly used.

These shareholder agreements may themselves give rise to M&A disputes. For example, one of the parties to the shareholder agreement may claim that an M&A transaction being pursued by the other party violates its rights, and may seek to obtain an order blocking the transaction or granting money damages if the deal goes through.[34] A party to a shareholder agreement that wants protection in the event that its partner enters into an unrelated transaction – for example, a party who wants the right to sell out of the joint venture if its partner changes ownership – must carefully bargain for the conditions that may trigger its right to sell out and how its stake in the business will be valued in such a sale.

Conclusion

For many reasons, arbitration is an attractive alternative to litigation when resolving high-profile, high-stakes disputes, and it is becoming increasingly popular for M&A disputes, particularly in the cross-border arena. To ensure that their contractual expectations are fulfilled, parties to M&A contracts governed by arbitration agreements should carefully consider arbitration's drawbacks as well as its advantages, and think about how they will be able to obtain relief in the event of a dispute, both pre- and post-closing.

34 For example, in the *Casino v. Diniz* arbitration, Casino sought an order in the arbitration barring CBD from agreeing a merger with Carrefour. See *supra* note 7. See also *Helm LLC v. Corp Group Holding Inversiones Ltda.*, Verified Petition for Injunctive Relief Pending Arbitration, No. 656601/2016 (N.Y. Sup. Ct. Dec. 20, 2016) (seeking an injunction against a transaction arising out of a merger of one of claimant's contractual partners).

Appendix 1

The Contributing Authors

Jonathan M Moses
Wachtell, Lipton, Rosen & Katz

Jonathan Moses is co-chair of the firm's litigation department, which he joined in 1998. He has represented clients in diverse industries, including banks and financial institutions, media companies and industrial firms. His practice includes government investigative proceedings, complex commercial and securities litigation, and international arbitration.
Prior to joining the firm, Mr Moses served as an attorney for the *New York Daily News*, where he worked on First Amendment issues. Mr Moses is also a former journalist, having served, among other positions, as a staff reporter for *The Wall Street Journal*. From 1990 to 1991, Mr Moses served as a speechwriter to Governor Jim Florio of New Jersey.

Mr Moses received an AB from Harvard University in 1988 and a JD from Columbia Law School in 1996, where he was an editor of the Law Review and a James Kent Scholar. Following graduation from Harvard, Mr Moses was the recipient of a Fulbright Fellowship in Hong Kong. Mr Moses also served as a law clerk to the Honorable Stephen F Williams of the United States Court of Appeals for the District of Columbia Circuit following graduation from law school.

Mr Moses is admitted to practise in the State of New York, the Southern and Eastern Districts of New York, the District of New Jersey and the US Courts of Appeals for the Second Circuit, Ninth Circuit and DC Circuit. He is a member of the Association of the Bar of the City of New York, the Federal Bar Council, where he currently serves as treasurer, and the American Law Institute. Mr Moses also serves as chairman of the board of the New York City Leadership Academy, an educational organisation that focuses on training leaders who will foster success in public schools, and is a member of the board of The Marshall Project, a non-profit news organisation focused on criminal justice.

Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, NY 10019
United States
Tel: +1 212 403 1388
Fax: +1 212 403 2388
jmmoses@wlrk.com
www.wlrk.com

M&A disputes can be unique in their hostility and complexity. *The Guide to M&A Arbitration* – published by Global Arbitration Review – is a new, practical guide intended to provide guidance on what merger parties should think about, when. It pools the wisdom of specialists who describe how to prevent these disputes arising and how best to resolve them when they do. The guide is structured in two sections. Part I consists of 10 chapters on planning and procedural issues, covering everything from drafting clauses to how to structure contracts to minimise the potential for disputes. Part II offers a geographical survey of important differences in national laws that may affect the outcome of a dispute. It is written by 39 specialists from a variety of backgrounds and takes a practical approach throughout.

Visit globalarbitrationreview.com
Follow @garalerts on Twitter
Find us on LinkedIn

ISBN 978-1-78915-100-8